

**CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM  
STATEMENT OF INVESTMENT POLICY**

**FOR  
REAL ESTATE**

**AprilFebruary 17, 2009**

*This Policy is effective immediately upon adoption and supersedes all previous real estate portfolio policies as described below.*

**I. PURPOSE**

The CalPERS Total Fund Statement of Investment Policy adopted by the CalPERS Investment Committee ("Committee") sets forth CalPERS' overarching investment purposes and objectives with respect to all its investment programs.

This document sets forth the investment policy ("Policy") for the Real Estate Investment Portfolio ("Portfolio"). The design of this Policy ensures that investors, managers, partners, consultants, and other participants selected by the California Public Employees' Retirement System ("CalPERS") take prudent and careful action while managing the Portfolio. Additionally, use of this Policy assures sufficient flexibility in managing investment risks and returns associated with the Portfolio.

Only the Committee has authority to waive any provision of this Policy.

**II. STRATEGIC OBJECTIVE**

The Portfolio shall be managed, consistent with CalPERS fiduciary responsibility as set forth in the CalPERS Total Fund Statement of Investment Policy, to accomplish the following:

- A. Provide diversification to the overall CalPERS Investment Portfolio;
- B. Generate attractive risk-adjusted rates of return for CalPERS; and,
- C. Provide a hedge against inflation.

**III. RESPONSIBILITIES**

- A. CalPERS' Investment Staff ("Staff") is responsible for the following:
  - 1. All aspects of Portfolio management, including monitoring, analyzing, and evaluating performance relative to the appropriate benchmark.

2. Reporting to the Committee no less than quarterly, in the form of a Quarterly Real Estate Staff Report, the following items:
  - a. **Policy Variance.** Information comparing actual Portfolio composition versus the Policy limits and ranges for [Key Policy Parameters](#). This section shall include:
    - (1) Variances for each Key Policy Parameter;
    - (2) Explanations of the variances and non-compliance, if any; and,
    - (3) A summary of the corrective plan and timeline to return the Portfolio to compliance with Policy.
  - b. **Leverage.** Information listing the:
    - (1) Amount and the type of leverage, including recourse and non-recourse amounts~~credit enhancements, and guarantees on the portfolio~~; and,
    - (2) Incremental changes to the recourse and non-recourse leverage amounts~~, credit enhancements, and guarantees for the most recent period.~~
  - c. **Investment Activity.** Information summarizing:
    - (1) Investment proposals under consideration~~received~~;
    - (2) Investment, Disposition, and Debt Financing Amounts~~Transactions~~ in due diligence; and,
    - (3) Investment, Disposition, and Debt Financing Amounts~~Transactions~~ closed during the ~~most recent period~~; and,
    - (4) ~~Dispositions during the period.~~
  - d. **Strategic Plan Update.** Information outlining progress towards implementation items in the most recent [Real Estate Strategic Plan](#) adopted by the Committee for the Portfolio.
3. Monitoring the implementation of, and compliance with, the Policy. Staff shall notify the Committee when the Portfolio is out of compliance ~~to the Committee~~ at the next meeting, or sooner if deemed necessary.

4. Screening, evaluating, and approving investment partnership proposals that meet Real Estate De~~legation~~ed Resolution authority (“Delegated Authority”) guidelines.
  5. Screening, evaluating, and recommending investment proposals to the Committee that are beyond the scope of Staff’s Delegated Authority.
  - 5.6. For approved transactions, negotiating investment partnership agreements and supervising the due diligence team in closing the investment partnership.
  - 6.7. In managing the Portfolio, Staff will work cooperatively with the external resources it has retained as part of the spring-fed pool. Their primary purpose shall be to serve as an extension of Staff.
  - 7.8. Pursuant to Delegated~~ion~~ Resolution Authority, Staff shall maintain an investment process including an internal Investment Review Committee (“IRC”) and a review by the CalPERS Real Estate Consultant. Each Investment, Disposition, and Debt Financing Amount will require an independent fiduciary due diligence engagement resulting in a favorable concurring opinion. The engagement is to be completed by one of the external resources in the spring-fed pool.
- B. The CalPERS Real Estate Consultant (“Real Estate Consultant”), who reports directly to the Committee, is responsible for:
1. Pursuant to Delegated~~ion~~ Resolution Authority, for prospective Investment, Disposition, and Debt Financing Amounts, the Real Estate Consultant shall participate in the IRC and provide comments to the IRC on the investment merits and risks of the transaction.
  2. Reviewing prospective Investment, Disposition, and Debt Financing Amounts for compliance with Policy and Delegated~~ion~~ Resolution Authority.
  3. Monitoring the performance and diversification of the Portfolio relative to the benchmark, Policy, and other market participants. Monitoring of all existing real estate managers and partners. Evaluating managers’ and partners’ performance, strategies, and organizational changes.

4. Reporting to the Committee no less than quarterly, in the form of a Quarterly Real Estate Consultant's Report. At a minimum, the report shall address~~comments on~~ the following items:
    - a. The performance and diversification of the Portfolio;
    - b. Leverage and, credit accommodation~~enhancements~~, and guarantee amounts on the Portfolio;
    - c. Compliance of the Portfolio with the Policy and Real Estate Delegation Resolution;
    - d. A status and summary of Investment, Disposition, and Debt Financing Amount~~transactions~~ reviewed through the IRC process; and,
    - e. The managers' and partners' performance, strategies, and organizational changes.
  5. Providing the Committee advice on trends and issues in the real estate marketplace.
- C. The General Pension Consultant ~~("Consultant")~~ is responsible for:
- Monitoring, evaluating, and reporting quarterly, to the Committee, on the performance of the Portfolio relative to the benchmark and Policy.
- D. Each mManager and partner is responsible for all aspects of portfolio management as set forth in each mManager's and partner's operating agreement or contract with CalPERS.

#### IV. PERFORMANCE OBJECTIVE AND BENCHMARK

The performance objective of the Portfolio is to meet or exceed the two benchmarks:

- A. Exceed (after fees) a minimum real rate of return of 5.0%; and,
- B. Exceed (before fees) a blend of the National Council of Real Estate Investment Fiduciaries Index ("NCREIF Index", also known as the "NPI" or the "NCREIF Property Index") and the Financial Times Stock Exchange ("FTSE") European Public Real Estate Association ("EPRA") National Association of Real Estate Investment Trusts ("NAREIT") Global Net Total Return Real Estate Index ("FTSE EPRA NAREIT Global Net Total Return Real Estate Index"). The overall benchmark ~~shall~~would be 90% weighted to NPI + 200 basis points and 10% weighted to FTSE EPRA NAREIT Global Net Total Return Real Estate Index. ~~The overall portfolio shall~~

maintain an appropriate level of diversification to mitigate risk. **[Moved to Section V.E.]**

## V. INVESTMENT APPROACHES AND PARAMETERS

### A. General Approach

1. ~~CalPERS~~The Portfolio shall provide capital to market leading real estate investment managers globally. As an effective partner, CalPERS will be among the preferred choices of ~~investment partnership~~ capital. This approach shall be pursued while maintaining the structures, systems, and processes to ensure that CalPERS' principal is preserved and risk-adjusted returns are maximized.
2. Top-down strategic assessments shall identify portfolio weightings and identify the most attractive segments of the market for investing. Based on these assessments, Staff shall proactively seek the most attractive investment opportunities, while maintaining appropriate diversification.
3. To manage the level of risk and return in the Portfolio, assets shall be categorized into risk classifications. Staff shall utilize investment structures including Commingled Funds, ~~Joint Ventures (Separate Accounts)~~ (investment partnerships), Manager Contracts, and Real Estate Operating Companies, and Downstream Joint Ventures. The preferred structure shall be Separate Accounts~~Joint Ventures~~. The focus of the Portfolio shall be in large strategic relationships. Investments may be made in public or private, debt or equity positions, or other related real estate investments.

### B. Strategic Planning

A Strategic Plan approved by the Committee shall be maintained by Staff that sets forth CalPERS' long-term objectives for investment and management of the Portfolio. The current, approved Strategic Plan shall be updated and presented to the Committee for approval periodically, as necessary. A new Strategic Plan will be presented at a minimum every five years.

### C. Risk Classifications

For effective risk management, the Portfolio shall be divided into three risk classifications: Core, Value Add, and Opportunistic. Allocations to the sectors shall be made to earn a high rate of risk-adjusted return.

Staff and the Real Estate Consultant shall assign assets to one of the three risk classifications based on the asset's overall risk profile after consultation with the Real Estate Consultant. To the extent practical, individual assets shall be assigned to the appropriate risk classification. Staff and the Real Estate Consultant shall monitor the Portfolio's actual weightings against the ranges and targets. ~~Variances from the ranges shall be reported to the Committee.~~ **[Included in reporting responsibilities above]**

As investments in the Opportunistic and Value Add risk classifications mature, their characteristics may migrate towards a more Core-like profile. Staff and the Real Estate Consultant shall monitor the Portfolio for instances when changes in the classification of investments are warranted. Reclassification ~~will must be made mutually agreed upon by Staff after consultation with~~ and the Real Estate Consultant and reported to the Committee.

## 1. Core Risk Classification

The Core risk classification includes investments that produce a predictable current net income yield after debt service. Typically Core assets shall exhibit institutional qualities that are well located within their local and regional markets and of high quality design and construction. Core assets shall include investments located only in Developed Markets~~Countries~~. Core assets shall have low leverage and generally low risk/return profiles.

Core assets shall be limited to traditional property types: Office, Retail, Industrial, Multifamily, and Hotels. Mixed use projects incorporating the traditional product types are also acceptable.

All Public Real Estate Securities shall be considered Core.

## 2. Value Add Risk Classification

The Value Add risk classification includes assets that have the expectation to produce a predictable current net income yield after debt service within a reasonable time frame, typically one to three years. Capital investment may be required to develop, lease, redevelop, or renovate the assets. Value Add assets may have moderate leverage and moderate risk/return profiles.

The Value Add risk classification shall include investments located primarily in Developed Markets. Stabilized (Core like) private assets in Emerging Markets shall be considered Value Add.

### 3. Opportunistic Risk Classification

The Opportunistic risk classification includes assets that have the expectation to produce substantial capital [appreciation](#) and higher yields. Current income may be low or non-existent during the holding period of the asset. Opportunistic investments often exist because of inefficiencies in real estate or capital markets. The Opportunistic risk classification shall include investments with assets located in Developed, Emerging, and [Frontier Markets](#). Investments in land shall be categorized as opportunistic. Opportunistic investments may have high leverage and high risk/return profiles.

#### D. Other Programs

To capitalize on trends in the real estate investment industry, the Committee may from time to time approve other programs. Investments in real estate assets made under these programs shall comply with all provisions of this Policy, including diversification limits and structuring requirements. To the extent these programs require specific policy direction, such direction will be provided as an attachment to this Policy. Attached hereto are the following specific programs:

1. Attachment A – For Sale Residential and Land Development;
2. Attachment B – California Urban Real Estate (“CURE”); and,
3. Attachment C – Public Real Estate Equity Securities.

#### E. Diversification and Limits

The overall Portfolio shall maintain an appropriate level of diversification to mitigate risk. Staff is responsible for maintaining a prudent level of diversification. Key Policy Parameters shall be measured at the Portfolio level, inclusive of all risk classifications, geographic guidelines, and property types. Classification of investments with respect to the Key Policy Parameters will be determined by Staff after consultation with the Real Estate Consultant. Ranges shall be based on current [Net Assets](#) at [Fair Market Value](#). The following are the Key Policy Parameters (with additional Key Policy Parameters in Section X):

## 1. Risk Classification (Core, Value Add, Opportunistic)

The Portfolio shall have the following ranges:

<u>Risk Classification</u>	<u>Range</u>
Core	20% - 80%
Value Add	10% - 60%
Opportunistic	10% - 40%

The Real Estate Strategic Plan shall contain target amounts for each risk classification. Progress toward target amounts will be reported to the Committee in the Quarterly Real Estate Staff Report.

## 2. Geographic Guidelines

CalPERS shall pursue a global real estate investment strategy. The following guidelines will apply across the Portfolio. The global universe will be divided as follows for purposes of delineating the geographic diversification of real estate investments:

<b>Region</b>	<b>Allocation</b>	<b>Definition</b>
<b>Developed Markets</b>  “Developed Markets” is further bifurcated into US and Ex-US markets.	75% -100%	As defined by the FTSE Global Equity Index Series.
US	40% - 90%	US NCREIF regions + Puerto Rico
Ex-US* *investment in any one Ex-US country is limited to 20% of the total real estate portfolio	10% - 60%	Any location outside of US market as defined above



<b>Emerging Markets</b>	0% - 20%	As defined by the FTSE Global Equity Index Series as “Advanced Emerging” or “Secondary Emerging”
<b>Frontier Markets</b>	0% - 5%	Countries not defined by the FTSE Global Equity Index Series as “Developed”, “Advanced Emerging”, or “Secondary Emerging”

In addition, Staff and the Real Estate Consultant shall monitor concentrations by region, country, and metropolitan area.

### 3. Property Type

The Portfolio will have the following limits:

	Limits
Office	35%
Industrial	35%
Retail	35%
Multifamily	35%
<a href="#">For Sale Residential and Land Development</a>	20%
<a href="#">Senior Housing</a>	10%
Hotels	10%
<a href="#">Other Property Types</a>	10%

### 4. Public Securities

Public Securities shall not exceed 25% of the Portfolio.

~~Classification of investments with respect to the above Key Parameters must be mutually agreed upon by Staff and the Real Estate Consultant.~~  
**[Moved to 1<sup>st</sup> paragraph of this section.]**

## F. Guidelines for Non-Developed Markets Investments

### 1. CalPERS Emerging Equity Markets Principles

Staff, managers, and Partners shall be guided by the CalPERS Emerging Equity Markets Principles for all real estate investments in such countries. Staff shall report any such exposure on an annual basis to the Committee.

2. United Nations Principles for Responsible Investment

For investments in Developed, Emerging, and Frontier Markets, Staff shall make every effort to apply the United Nations Principles for Responsible Investments.

3. Frontier Market Investing

Frontier Market investing shall be allowed only if approved by the Committee, with the following exception. Investments in individual commingled funds which contain strategies for investing up to 10% in Frontier Markets are permissible ~~shall be allowed~~ and are not required to be approved by the Committee.

G. Quality Control

1. Staff Internal Procedures Manual

Staff shall maintain an internal procedure manual ("Manual"). The Manual will provide guidance and mandatory steps for key procedures, risk mitigation measures, and processes in the Global Real Estate Unit. The Senior Investment Officer, Real Estate ("SIO-RE") and Real Estate Consultant shall approve the initial Manual. Annually, Staff and the Real Estate Consultant shall review the ~~Staff Internal Procedure Manual~~ to ensure the Manual is consistent with best business practices in the institutional investment industry. Changes to the Manual require the Senior Investment Officer's ("SIO-RE's") and Real Estate Consultant's approval.

2. Due Diligence Process

Staff shall conduct and manage a due diligence process for new Investment, Disposition, and Debt Financing Amounts. The Real Estate Delegation Resolution includes specific requirements for reviews.

3. Process Monitoring

Staff shall maintain reports and systems to monitor transaction processing, due diligence, and approvals to ensure timely decision making and an effective process.

#### 4. Database

Staff shall maintain information systems, including a relational database, to provide analysis of the Portfolio's current composition. The systems will assist in maintaining the diversification of the Portfolio.

#### H. Specific Risk Parameters

There are specific risks associated with investments that shall be monitored and mitigated. Each segment of the real estate market contains uncertainties that are unique to it. Staff shall manage and monitor and the Real Estate Consultant shall monitor the following major categories of uncertainties commensurate with the expected return as an investment proposal is considered:

##### 1. Concentration Risk

Excessive concentration of the Portfolio in a particular vintage year, geographic location, product type, or life cycle stage will increase the volatility and risk of the Portfolio.

##### 2. Structural Risk

Generally, CalPERS accesses the real estate markets by providing equity to partnerships. The terms and conditions of these partnerships will have a material impact on the liquidity of CalPERS' capital.

##### 3. Liquidity

Real estate is an illiquid asset class, particularly during periods of tight credit markets. In addition, there can be illiquidity at the partnership levels of the investment vehicle.

##### 4. Leverage

Increasing Portfolio leverage will increase volatility, magnifying both positive and negative changes in appreciation and depreciation. Specific risk controls associated with leverage are detailed in Section X.

##### 5. Country Risk

Individual country real estate markets and financial environments will present unique investment risks. Currency exchange rates will impact returns. CalPERS' [international](#) investments may be subject

to taxation. For developed markets there will be a lack of reliable and consistent real estate market information and local employment and demographic data. Regulatory environments, legal systems, and political systems will vary by country and may change over time. Repatriation of capital is a risk in some countries.

6. Development Risk

Development projects have entitlement risks which require management. Changes to the entitlement status of a parcel will have dramatic impact on the value of an investment. Generally, the further along in the entitlement process, the lower the risk. Development projects also have the potential for construction cost overruns which can impact returns of the project.

7. Hazardous Waste

Real estate may be contaminated by hazardous materials. The cost of clean-up and other liabilities created by environmental laws associated with contaminated real estate may have a significant effect on investment returns. The risks may be addressed by conducting appropriate investigations of potential hazardous materials contaminations in the due diligence review of the real estate to assess environmental risk and, if it exists and mitigation is feasible, adopting appropriate risk mitigation measures. ~~present a unique operational risk, particularly in the United States, as potential liability from a Hazardous Waste clean-up can exceed CalPERS' investment amount. In addition, financial liability may extend past the period of ownership.~~

8. Operating Risk

Real estate investments contain a business operating risk component. Certain property types have a greater business operating component, such as Hotels.

## VI. CALCULATIONS AND COMPUTATIONS

A. Real Estate Valuations

Real estate valuations shall be governed by the Statement of Investment Policy for ~~Real Estate Appraisal~~ of CalPERS Real Estate Interests and Valuation.

B. Performance Measurement

A comprehensive Real Estate Quarterly Performance Report for the Portfolio shall be prepared by the Performance Monitoring Unit in accordance with the Statement of Investment Policy for Real Estate Appraisal of CalPERS Real Estate Interests and Valuation. The Global Real Estate Unit shall be responsible for reviewing and providing comments to Quarterly Performance Reports.

## VII. INVESTMENT STRUCTURES

CalPERS may invest capital for the Portfolio through a variety of legal strategies will be pursued utilizing several structures, including Commingled Funds, Joint Ventures (also known as Separate Accounts), Manager Contracts, Real Estate Operating Companies, and Downstream Joint Ventures. Manager Contracts. Investment partnerships in which CalPERS invests may be structured as partnerships, limited liability companies, corporations, or trusts. CalPERS should be a limited liability investor in order to limit any loss to the amount of the investment. CalPERS should possess an appropriate level of control over management of the investment partnership.

### A. Types of Structures

#### 1. Commingled Fund Structures

- a. In a Commingled Fund, CalPERS is one of many investors in an investment partnership managed by a general partner or manager. Investor governance and control provisions for Commingled Funds should reflect the proportion of capital being supplied by CalPERS in relation to the capital of the other investors.
- b. Investments in closed end funds, opened end funds, and side by side Co investments vehicles are allowed.
- c. Commingled Fund structures shall be utilized only under the following conditions:
  - (1) The Commingled Fund provides only access to a superior management team; and,
  - (2) The Commingled Fund provides access to a unique investment strategy.
  - (3) Governance and control provisions for Commingled Funds should reflect the proportion of the total capital being supplied by CalPERS.

## 2. Separate Account~~Joint Venture Structures (Separate Accounts)~~

a. A Separate Account is a form of investment partnership between CalPERS and a manager or partner. It creates a beneficial one-on-one relationship to invest capital for the Portfolio. The manager or partner should undertake the fiduciary duty to perform its responsibilities solely in the interest of CalPERS and should agree to use reasonable care and prudence in performing those responsibilities. Staff should endeavor to implement a strategy to align the investment interests of CalPERS and the manager or partner in the Separate Account by employing such techniques as co-investment of capital by the manager or partner, dedication of a senior management team to the investment partnership, and payment of incentive compensation for achievement of investment targets.

b. Based on the criteria described in Section VIII.C of this Policy, CalPERS may enter into~~Staff may negotiate Separate Accounts~~Joint Ventures with any of the following types of managers or partners:

- (1) Developers;
- (2) Owner Operators;
- (3) ~~Public~~—Real Estate Operating Companies~~Equity Securities~~;
- (4) Investment Managers; and,
- (5) Emerging Managers.

~~b-c.~~ Governance and control provisions for CalPERS in Separate Accounts~~Joint Ventures should reflect the proportion of the total capital being supplied by CalPERS. Joint Venture Partners be adequate to protect the interests of CalPERS considering the amount and term of the capital commitment of CalPERS, the size and number of the investments in the Separate Account, the duration of the Separate Account, and CalPERS' experience and relationship with the manager or partner. The manager or partner may be given discretion to execute investment transactions as long as all transactions which comply with applicable CalPERS Investment Policies and the requirements of the Separate Account agreement~~the partnership's plan. This includes

~~investments in other joint ventures (downstream joint ventures). However, all transactions will comply with CalPERS policies in place at execution of the partnership, have size limitations, and comply with parameters approved by Staff (discretion in a box).~~

~~(1) The CalPERS commitment can span multiple years; however, CalPERS shall retain the right to terminate the commitment after a reasonable lockout period.~~

~~(2) The operating partner may be allowed to reinvest proceeds of asset dispositions, so long as the Joint Venture is achieving the objectives of the original investment.~~

### 3. Manager Contracts

a. Manager Contracts are which are contracts between CalPERS and a manager to accomplish a particular investment strategy, should be used primarily used for Public Real Estate Securities investments.

b. Manager Contracts should be structured to comply with CalPERS' contracting policies.

### 4. Real Estate Operating Company Investments

~~CalPERS~~Staff may make strategic investments in private companies which derive a substantial majority of revenues from the real estate activities. Operating companies are a high risk/return investment and should be priced accordingly.

### 5. Downstream Joint Ventures

a. A Downstream Joint Venture is an investment partnership between a Commingled Fund or a Separate Account (or CalPERS directly) and one or more third parties to invest as co-owners in real estate. Downstream Joint Ventures increase liquidity risk by increasing the inability of CalPERS to dispose of its investment in a timely manner and add credit risk of potential loss due to the default of the third party Downstream Joint Venture partner.

b. The governance rights of CalPERS (or its Separate Account) as well as the right to receive distributions of income and profits should be proportionate to the amount or value of the contributions of the Downstream Joint Venture partners.

CalPERS (or its Separate Account) should have an exit strategy (such as a buy/sell procedure in the Joint Venture agreement) to permit liquidation of the investment.

B. Legal Structures

Investment pPartnership agreements will utilize, to the extent practicable, a legal structure which:

1. Limits CalPERS' financial exposure; and,
2. Minimizes tax, fee, and other~~fee~~ liabilities.

C. Required Terms

Staff shall maintain, as part of the ~~Staff Internal Procedures Manual~~, a standardized list of required and recommended or suggested terms to be included in ~~each~~investment partnership agreements ~~negotiated~~.

## VIII. INVESTMENT SELECTION

A. Investment Authority

~~Managersment firms~~ and partners shall be selected by CalPERS Staff or the Committee pursuant to ~~Delegatedion Resolution A~~ authority. The Real Estate Delegation Resolution specifies when Committee~~Board~~ approval of an Investment, Disposition, and Debt Financing Amount is required.

B. Investment Process

~~Pursuant to the Delegation Resolution, W~~when Staff has Delegated Authority, the following steps are required to be completed prior to closing an Investment, Disposition, and Debt Financing Amount:

1. **SIO-RE.** SIO-RE approval is required after review by the IRC;
2. **Review from Real Estate Consultant.** Review by the Real Estate Consultant is required. Review is defined as participation in the IRC, including documentation of the Real Estate Consultant's comments;
3. **Independent Fiduciary Concurring Opinion.** An Independent Fiduciary due diligence engagement is required to be performed ~~by a Pool Real Estate Consultant~~. A written favorable concurring opinion is required;



4. **Policy Compliance Review.** The Real Estate Consultant is required to document the transaction complies with Policy and Delegated ~~Resolution~~ Authority; and,
5. **Legal Review.** The Legal Office is required to document the transaction complies with Delegated ~~Resolution~~ Authority.

C. Investment Criteria

Prospective managers and partners and ~~fund~~ investments shall be evaluated for selection based upon, but not limited to, the following criteria:

1. The suitability of the prospective investment strategy relative to the Real Estate Strategic Plan.
2. The expected risks and returns of the investment.
3. The investment time horizon and potential exit strategies for investments.
4. The quality, stability, integrity, and experience of the management team.
5. The management team's track record.
6. The leverage strategy of the proposed investment and its compliance with CalPERS' policy and ~~t.~~—The management team's track record specifically with respect to ~~their~~ utilization of leverage.
7. The ability and willingness of the organization to dedicate sufficient resources and personnel to optimally manage CalPERS' investments.
8. The reasonableness of investment terms and conditions, including provisions to align interests of the firm, the management team, and CalPERS.
9. The amount of co-investment by the firm and the management team.
10. The profit sharing plan of the firm.
11. The appropriateness of management controls and reporting system.
12. The potential tax liabilities of the investment.

## IX. MANAGER AND PARTNER MONITORING

Staff shall monitor and evaluate managers and partners on an ongoing basis based on performance relative to stated objectives of the governing documents. The financial strength of the investment management organization, the level of client service given CalPERS, and changes within the managing organization shall be evaluated. The continuity of personnel assigned to CalPERS investments and overall staff turnover shall be reviewed.

## X. LEVERAGE

Leverage may be utilized in the Portfolio to enhance returns. The increased risk associated with higher levels of leverage shall be considered in establishing acceptable rates of return.

### A. Leverage Limitations

Leverage limits shall be imposed at the Portfolio and Risk Classification levels. Leverage limitations shall be measured on a Loan-to-Value (LTV) ratio and Debt Service Coverage Ratio basis.

Loan-to-Value Limits:

<u>Risk Classification</u>	<u>LTV</u> <u>Risk Classification</u> Limit	Portfolio Limit
Core	45%	60%
Value Add	65%	
Opportunistic	75%	

The average leverage guidelines in the table above are applicable for each category. Individual investments within a category may exceed the guideline. The above limitations apply to all debt, excluding Public Real Estate Securities, in total including recourse and non-recourse debt.

The Debt Service Coverage Ratio for the Core risk classification will have a minimum value of 1.50. The Value Add and Opportunistic risk classifications will have no minimum Debt Service Coverage Ratio.

### B. Leverage Structures

Interest rate structures may include fixed or variable/floating interest rates and amortizing or non-amortizing structures. Lines of Credit secured by the partnership or partnership assets are permissible. Hedging techniques utilized by partners to control interest rate risk may be used including, but not limited to interest rate swaps, interest rate caps, and collars. Prudent

use of both fixed and variable/floating interest rate structures are appropriate in a dynamic real estate portfolio.

Leverage may be secured or unsecured and recourse or non-recourse. Recourse debt is debt for which CalPERS has the obligation (direct or indirect, absolute or contingent) to pay the debt to the lender. Debt that may be recourse to a Separate Account or a Commingled Fund or a Joint Venture but for which CalPERS has no obligation will be treated as non-recourse debt for the purpose of this Policy.

C. Recourse Debt

1. Limitations

The total Recourse Debt Allocated shall not exceed 10% of the lower of the current Net Asset Value or the target Net Asset Value of the Portfolio.

2. Approval of Utilization of Recourse Debt

Utilization of recourse debt incurred by CalPERS requires written approval by the SIO-RE (subject to discretion allowed by the Real Estate Delegation Resolution).

3. Types of Recourse Debt

Two types of recourse debt are allowed: Subscription Financing and Credit Accommodation.

a. Subscription Financing

Subscription financing is short term financing utilized by Separate Accounts~~joint ventures~~ and commingled funds to consolidate and finance capital calls. The lender's security for subscription financing is a pledge from CalPERS to fund the capital calls. Subscription financing may be utilized in the Portfolio subject to the following limitations:

1.(1) The amount of Ssubscription Financing Allocated secured by CalPERS' capitalequity commitment cannot exceed CalPERS' equity commitment;

2.(2) The Ssubscription Financing Outstanding cannot be outstanding more than 12 months; and,

~~3.(3) The total Subscription Financing Outstanding amount shall be included in the treated as debt, however, it shall not be counted against LTV limit calculation the Portfolio leverage limitation so long as it is outstanding less than 12 months.~~

~~D. b. Credit Accommodation Guarantees~~

~~Credit accommodation generally refers to a guaranty executed by CalPERS whereby CalPERS agrees to pay the debt obligation of an entity, in the event the entity fails to pay the debt obligation. The entity will usually be a limited partnership or limited liability company, and will be majority-owned by CalPERS. The debt obligation that CalPERS guarantees will be evidenced by an extension of credit (e.g., loan, line of credit, or other form of credit facility) by a financial institution to the entity. The benefit provided to CalPERS is that the guaranty will tend to lower the borrowing cost for the entity and should, in turn, enhance the overall return to the real estate investment. Guarantees become a contingent liability on the CalPERS' overall balance sheet and should be used only when they provide economic benefit. Credit accommodation differs from credit enhancement in that a credit accommodation does not derive its rating from the CalPERS' Credit Enhancement Program (CEP) rating (either implied or explicitly). In addition, Credit Accommodation is made for an entity in which CalPERS has an existing, or proposed, ownership interest. Credit enhancement is the use of CalPERS' balance sheet, through the program rating, in which CalPERS has no initial ownership interest and where CalPERS receives explicit consideration for the enhancement. CalPERS loan guarantees and credit enhancements shall not exceed 10% of the Net Asset Value of the Portfolio. All guarantees and credit enhancements will be:~~

- ~~1. Approved by the SIO-RE (subject to discretion allowed by Real Estate Delegation);~~
- ~~2. Reported to the Committee as part of the Quarterly Real Estate Performance Report;~~

~~(1)3. With the exception of transactions included in (24) below, guarantees and credit accommodations enhancements will not exceed 10 years from the closing of the investment, and,~~

(2)4. For affordable housing, workforce housing, and community development investment transactions financed in part with public subsidiaries, ~~guarantees and credit accommodations~~ enhancements will not exceed 30 years from the closing of the investment.

(3) The total Credit Accommodation Outstanding amount shall be included in the LTV limit calculation.

D. Reporting

Staff will report on leverage and incremental changes in leverage as part of their responsibilities outlined in Section III.

## **XI. GLOSSARY OF TERMS**

Key words used in this Policy are defined in CalPERS' Master Glossary of Terms.

## **XII. PREVIOUS REAL ESTATE PORTFOLIO POLICIES**

Previous real estate portfolio policies superseded by this Policy are:

A. California Urban Real Estate Policy

B. Core Apartment Real Estate

C. Core Industrial Real Estate

D. Core Office Real Estate

E. Core Retail Real Estate

F. Enhanced Core Index Public Real Estate Equity Securities

G. Equity Real Estate

H. Equity Real Estate Joint Ventures

I. Equity Real Estate Leverage

J. Franchise Finance Real Estate

K. Geographic Guidelines for Real Estate Investment

- L. Global Public Real Estate Equity Securities
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- S. Senior Housing Program
- T. Single Family Housing Program

Approved by the Policy Subcommittee: April~~December~~ 17~~5~~, 2009~~8~~

**FOR SALE RESIDENTIAL AND LAND DEVELOPMENT PROGRAM**

**AprilFebruary 17, 2009**

**I. PURPOSE**

This attachment sets forth the investment policy ("the Policy") for the For-Sale Residential and Land Development Program ("the Program"). The design of this Policy ensures that investors, managers, consultants, or other participants selected by the California Public Employees' Retirement System ("CalPERS") take prudent and careful action while managing the Program. Additionally, use of this Policy provides assurance that there is sufficient flexibility in controlling investment risks and returns associated with single-family housing investment.

Investments in the Program shall comply with all requirements of the Real Estate Policy.

**II. STRATEGIC OBJECTIVE**

Achieving the highest total rate of return possible consistent with a prudent level of risk, the liabilities of CalPERS and investment guidelines herein are the strategic objective of the Program.

The Program shall be considered a specialized component of the opportunistic risk category and, as such, shall be required to achieve an appropriate risk-adjusted return. The *primary* emphasis of the Program is in the state of California.

The Program shall be managed to accomplish the following:

- A. Preserve investment capital;
- B. Generate attractive risk-adjusted rates of return for CalPERS as a total return investor;
- C. Provide a hedge against inflation; and
- D. Consider solely the interest of CalPERS' participants and beneficiaries in accordance with California State Law.

### III. INVESTMENT APPROACHES AND PARAMETERS

#### A. Risks

There are risks associated with investment in the single-family residential housing industry. The primary risks include, but are not limited to, the following:

##### 1. [Land Entitlement Risk](#)

- a. Land entitlement risk reflects the risks assumed by an investor when purchasing a parcel of land prior to the tentative map and other discretionary political approvals being granted by the appropriate regulatory bodies (i.e., municipalities or planning agencies, or both) as to the final use of the property.
- b. In order to limit this risk, CalPERS shall invest primarily in land where a tentative map for the project has been obtained. The Program exposure to unentitled land shall generally not exceed 20% of the actual invested total Housing Program Portfolio.

##### 2. Project/Development Risk

- a. Investment in single-family residential development and construction entails assuming the normal risks associated with development of this property type.
- b. These risks, some of which are controllable, include, but are not limited to, the following: cost overruns, project delays, contractor disputes, ineffective marketing, slow sales, price modifications, and potential litigation.
- c. Partners who are selected by CalPERS to manage funds invested in this property type shall be expected to undertake all appropriate steps to mitigate these risks.

##### 3. Interest Rate Risk

- a. Fluctuating interest rates affect the affordability of housing for all buyers, especially for price-sensitive first-time buyers.
- b. The risk to the investor and homebuilder is that the standing inventory of homes may remain unsold for an extended period of time.



- c. The risk can be mitigated by careful economic analysis of market cycles, limited project life cycles, controlled standing inventory (by limiting starts ahead of sales), and maintained flexibility on pricing.
- d. Interest rate risk can also be partially mitigated by using interest rate hedging.
- e. Partners who undertake to manage invested funds in this property type shall be expected to closely examine strategies to mitigate interest rate risks and execute such strategies when appropriate.

## **B. Diversification**

The Program shall be well diversified to minimize risk due to overexposure to any one risk factor. The Program shall be diversified by geography, strategy, product type, price mix, builder, project, and development life cycle. From time to time, adjustments to correct the actual investment to comply with the Policy allocation ranges shall be implemented on an opportunistic basis over a reasonable time frame (normally within a three-year period) and with ample consideration given to preserving investment returns to CalPERS.

CalPERS shall periodically review the Portfolio and Program Guidelines. CalPERS shall notify the partners when the Portfolio violates diversification guidelines and portfolio leverage.

### **1. Diversification by Geography**

The Program shall diversify by geography. Major urban and suburban markets and submarkets shall be considered, but not more than 25% shall be invested in any single Metropolitan Statistical Area (MSA). California is the current primary focus of the Program, but CalPERS shall consider investments outside of California. In considering such investments outside of California, CalPERS shall maintain or strive to increase commitments within California consistent with its fiduciary obligations. The geographic allocation shall be reviewed periodically to determine appropriate levels.

### **2. Diversification by Strategy**

CalPERS shall employ a broad range of strategies for Program investment. Allocation ranges for each strategy have been established and are listed below. To mitigate risk, CalPERS shall

place less emphasis on strategies carrying a greater degree of uncertainty.

<u>Strategy</u>	<u>Allocation Range</u>
<a href="#"><u>Housing Joint Ventures</u></a>	50 – 100%
<a href="#"><u>Land Development</u></a>	0 – 50%
Off-balance-sheet Financing	0 – 40%
Unentitled Land	0 – 20%
Entity Level Investments	0 – 10%
Related Investments	0 – 10%

The total allocation to land development, unentitled land, and off-balance sheet financing shall not exceed 50% of the Program.

3. Diversification by Product Type

Emphasis shall be placed on owner-occupied primary residences and entry-level housing. Other product types shall be considered, including, but not limited to, the following: first-time-move-up and second-time-move-up.

4. Diversification by Price Mix

The Program shall consider ranges of lot/home pricing that are appropriate within each region and submarket. Actual price levels shall be determined by specific markets and submarkets. The Program shall encourage, but not be limited to, affordable housing projects, which otherwise meet all prudent investment criteria. Pricing of homes shall be consistent with the first, second, and third-time buyers for the particular geographic market, within the limits otherwise established within the Policy.

5. Diversification by Builder

The Program shall consider diversifying among various builders to avoid business risk associated with a single partner entity. In the context of this Policy, “Builder” shall refer to either a homebuilder or a residential land developer. Builders shall represent expertise in a range and diversification of price mix and geography, and selection shall be based on financial strength and industry expertise. The desired Builders shall be leading developers with at least ten years’ experience in the single-family housing or—residential land development industry.

For Committee and Staff contemplating the construction of homes, the desired Builders shall be either leading homebuilders (top tier),

or regional Builders with a niche focus on single-family residential development or affordable housing (second tier). For purposes of this Policy, a top-tier homebuilder is defined as one within the top 50 producers of homes within California (or the applicable state) during each of the last three years.

No more than 20% of total capital shall be committed to any one homebuilder. For the purposes of this Policy, entities that have substantial common ownership (greater than 10%) shall be considered a related entity; therefore, they shall be considered one Builder.

6. Diversification by Project

The Program shall diversify investments in such a manner that no one project shall dominate an individual partner allocation. No more than 35% of an individual Partner allocation, capped at \$100 million, shall be invested in any single project without CalPERS approval.

7. Diversification by Development Life Cycle

The Program shall diversify investments such that the development life cycle shall vary. Development Life Cycle is the total time the project progresses from market entry to exit. The maximum time period for completion of the development cycle of acquisition, development, construction, and sellout shall generally be five years. The expected project life cycle, from acquisition of entitled or unentitled land through the completion of construction of the final home, should be five years or less. No project with a life cycle greater than five years is permitted without the Staff's approval, except where partnership investment capital is returned within five years.

**C. Investment Objectives and Criteria**

1. Housing Joint Ventures

- a. "Housing Joint Ventures" refers to properties that are acquired with the intention to develop or construct homes (including all forms of development for single-family housing, such as condominiums, town homes, zero lot line developments, planned unit developments with and without common areas, and standard subdivisions).

b. Investment Criteria

- (1) Generally, project size shall be limited to 400 units. Staff has the discretion to approve larger projects after reviewing investment parameters; and,
- (2) Each project shall be required to produce a minimum real rate of return (after fees) of 6%.

2. Land Development

- a. "Land Development" refers to properties that are acquired with the intent to develop or construct infrastructure (including all forms of acquisition and infrastructure development for single-family housing, such as condominiums, town homes, zero lot line developments, planned unit developments with and without common area, and standard subdivisions).

b. [Incidental Development](#)

- (1) Incidental commercial/multi-family infra-structure lot development may be undertaken in the Program, provided that it is not a major cost of the overall single-family project.
- (2) Golf course construction may be undertaken provided that it is an essential or required component of the overall master plan for the single-family project. Furthermore, the business plan must contemplate liquidation of the golf course at or before the end of the project.

c. Investment Criteria

- (1) All Land Development investment shall meet the following conditions:
  - (a) Comply with the general plan and zoning ordinance of the governing jurisdiction;
  - (b) Comply with the provisions of the California Environmental Quality Act (CEQA) in California, or comparable local, state and federal environmental quality laws in other states;

- (c) Have an approved tentative map for the master development (tentative maps for individual parcels for sale to merchant builders are not required) or, as applicable, a development agreement approved by the governing jurisdiction; and,
  - (d) Have received any other major discretionary approvals including those of the Coastal Commission and Local Agency Formation Commission, as applicable or comparable local, state, and federal agencies. This condition does not include the issuance of routine procedural approvals, (e.g., Department of Transportation, Fish & Game, Corps of Engineers, grading permits, building permits, or storm water discharge permits).
- (2) Generally, project size shall be limited to no more than 3000 lots. The Staff has the discretion to approve larger projects after reviewing investment parameters; and,
- (3) Each investment shall be required to produce a minimum real rate of return (after fees) of 8%.

### 3. Off-balance-sheet Financing

- a. “Off-balance-sheet Financing” is a financing structure that allows a developer to improve its land without carrying the land inventory on its balance sheet. Typically, the developer is a publicly held company (“Public Builder”). CalPERS housing partners shall acquire the unimproved land from the Public Builder. Concurrent with the execution of the purchase and sale agreement, the partnership and the Public Builder will execute an option agreement granting the Public Builder the option to repurchase finished lots. Off-balance-sheet financed projects will be subject to the same policy requirements as conventionally financed projects.
- b. Investment Criteria
  - (1) Project size shall be limited to the same criteria as above. Staff shall have the discretion to approve

larger projects after reviewing investment parameters;  
and,

- (2) Each investment shall be required to produce a minimum real rate of return (after fees) of 7%.

#### 4. Unentitled Land

- a. "Unentitled Land" refers to land that complies with the general plan but does not have a tentative map, specific plan approval, zoning, or a development agreement from the governing jurisdiction.

- b. Investment Criteria

- (1) Generally, project size shall be limited to the same criteria as Housing Joint Venture and Land Development; and,
- (2) Each investment shall be required to produce a minimum real rate of return (after fees) of 10%.

#### 5. Entity Level Investments

- a. "Entity Level Investments" refers to investments in debt, equity, or hybrid securities of entities whose principal assets are residential real estate.

- b. Investment Criteria

- (1) CalPERS shall not make passive investments in publicly traded securities under this Program.
- (2) The minimum real rate of return (after fees) shall be determined on a case-by-case basis, depending on the applicable risk factors and structure of the investment opportunity.

#### 6. Related Investments

- a. "Related Investments" refers to other forms of investment not described above, debt or equity, related to Housing Joint Ventures, Land Development, Off-balance-sheet Financing, Unentitled Land, or Entity Level Investments.

b. Investment Criteria

- (1) Generally, project size shall be limited to the same criteria as Housing Joint Venture and Land Development. The Staff has the discretion to approve larger projects after reviewing investment parameters; and,
- (2) The minimum real rate of return (after fees) shall be determined on a case-by-case basis, depending on the applicable risk factors and structure of the investment opportunity.

**D. Structure**

1. Leverage

CalPERS desires an appropriate and diversified use of leverage (e.g., third-party entity, Mello-Roos, or other project financing debt). A range of leverage at investment level and entity level may be used by CalPERS' partners.

The maximum amount of leverage on the Program Portfolio shall be 60% of cost or market value, whichever is greater. Leverage on individual projects shall not exceed 75% of cost or market value, whichever is greater. A temporary out-of-compliance period shall be allowed up to 75% leverage on the Program for no more than a six-month period, in which the General Partner's cash flow projection shows the Program returning to a 60% leverage ratio or less. In the event that the six-month period is not met, or projections exceed the temporary adjustment period, a capital call shall be made on the applicable partner or new investments in the applicable partnership shall cease. Unentitled Land shall not be leveraged unless it is favorable, non-recourse seller financing.

2. Equity

Equity requirements shall be set by the Program Guidelines. CalPERS recognizes that the financing markets for homebuilding projects are dynamic; therefore, CalPERS shall review and reconsider the equity requirements, as set forth in the Program Guidelines every six months.

**E. Vehicles**

Limited partnerships, limited liability companies, real estate operating companies, commingled funds, and separate accounts shall all be considered appropriate investment vehicles for implementing investments in this property type. However, any such vehicle chosen shall have a finite life and a requirement that the investment be self-liquidating at a time CalPERS considers appropriate. In all cases, CalPERS' investment and risk of loss shall be limited to the amount initially committed. CalPERS and its partners shall structure transactions and utilize vehicles to minimize tax-related issues.

**F. Program Guidelines**

1. CalPERS shall maintain standardized Program Guidelines in the Staff Internal Procedures Manual, which establishes operating definitions of program commitment periods, priority returns due CalPERS, and partner fees allowable. Program Guidelines may be changed from time to time in response to changing market conditions.
2. Program parameters in the Program Guidelines shall be developed by the real estate staff and the Real Estate Consultant as appropriate, and are subject to the approval of the Committee. Important program parameters shall include the following:
  - a. Program Size - Funds allocated to the market segment;
  - b. Timing - Target date for investment of allocated funds;
  - c. Diversification - Target allocation of funds among geographic regions and submarkets within the market segment, as appropriate;
  - d. Investment Guidelines - Specification of the investment guidelines for acceptable investments within the market segment; and,
  - e. Asset and Project Management - Specification of the expected value-enhancing activities that shall result in maximizing returns to CalPERS.
3. Unless specifically delegated in the contract, decision making in the Program shall be governed by the Real Estate Delegation of Authority.



#### **IV. PARTNER RESPONSIBILITIES**

##### **A. Responsibility**

The partner responsibilities shall include fiduciary responsibility to invest and manage CalPERS' funds in this property type in a manner consistent with the Program Guidelines, as revised from time to time (in effect at the time of each project commitment by a partner), and within the limits set by this Policy.

##### **B. Discretion**

The partners shall have investment discretion regarding all project investment decisions; however, they shall comply with the stipulations outlined in the Policy regarding CalPERS approvals.

##### **C. Reporting**

CalPERS shall require that the partners make periodic reports as requested. CalPERS shall also have the right to audit and review the books, records, and operations of the partners. Such reviews may be conducted either by CalPERS Staff or by consultants at CalPERS' discretion.

##### **D. Conflicts of Interest**

As part of the partners' standard reporting procedures, the partners shall fully disclose to CalPERS any existing relationships that may qualify as conflicts of interest.

#### **V. GENERAL**

Investment in the Program shall include direct or partnership investments where the predominant end-use is for-sale residential property or finished residential lots. This shall include single-family home construction as well as infrastructure development construction (including all forms of acquisition and infrastructure development for single-family housing, such as condominiums, town homes, zero lot line developments, planned unit developments with and without common areas, and standard subdivisions). Incidental commercial/multi-family infrastructure lot development, including golf course construction, may be undertaken in the Program with certain restrictions.

#### **VI. PROJECT MANAGEMENT**

Management Firms and Partners shall act in a fiduciary capacity, representing CalPERS' interests in project management decisions, and-providing daily project

management services, as expertise and organizational structure allow. CalPERS shall give appropriate Delegation of Authority to management firms and require that they provide adequate measures of accountability.

A. Investor Approval

CalPERS shall require that it be informed of, but shall not participate in, the resolution of significant events that affect the investment and development process. Examples of these events include significant project cost overruns, schedule delays, contractor disputes, or commencement of litigation, and so forth. CalPERS' approval rights shall be limited to those matters specified in this Policy and the Program Guidelines, approval of partnership level debt, major modifications of the partnership's investment structure, settlement of claims in excess of \$500,000, contracts with partners' affiliates, and other major partnership events.

B. Periodic Review

Partner relationships shall be subject to periodic review by CalPERS. The review shall include, but not be limited to, the following:

1. Original project schedules compared to actual deliveries;
2. Actual-compared-to-projected profit margins and absorption rates; and,
3. Actual-compared-to-projected returns, current and forecasted capital environments, market conditions, portfolio leverages, portfolio diversifications, and adherence to Policy and Program Guidelines.

**CALIFORNIA URBAN REAL ESTATE**

**AprilFebruary 17, 2009**

**I. PURPOSE**

This attachment sets forth the investment policy ("the Policy") for the California Urban Real Estate (CURE) Program ("the Program"). The design of this Policy ensures that investors, managers, consultants, or other participants selected by the California Public Employees' Retirement System ("CalPERS") take prudent and careful action while managing the Program. Additionally, use of this Policy provides assurance that there is sufficient flexibility in controlling investment risks and returns associated with the execution of real estate investment strategies.

Investments in the Program shall comply with all requirements of the Real Estate Policy.

**II. STRATEGIC OBJECTIVE**

Achieving the highest total rate of return for CalPERS is the strategic objective of the Program.

CURE investments include, but are not limited to low-to-moderate-income housing, multi-family low-income housing, commercial or residential or both, urban infill, community redevelopment, and rehabilitation of core properties. CalPERS shall make such investments under specified conditions and circumstances as described in this Policy. The structure of investment and long-term rate of return shall relate to the relative risk of the investment due to the type, nature of, and relative control over the investment. Minimum acceptable returns shall stay consistent with those defined by the Real Estate Policy. Returns shall remain acceptable unless the level of risk, as a result of guarantees or subsidies, is below the level associated with other real estate investments made by CalPERS.

**III. INVESTMENT APPROACH AND PARAMETERS**

**A. Approach**

Investment in the Program does not imply reduced expectations for returns or increased willingness to accept risk. CalPERS shall only invest in situations where the investment risk is no greater than in other real estate investments made by CalPERS. If the risk inherent in a particular

project is unacceptably high, then CalPERS shall require guarantees, subsidies, or other financial assistance by government agencies to reduce risk to an acceptable level.

CalPERS shall ensure investments meet the following criteria:

1. Meet standard of prudence required of other investments, and thus affirmatively meet the prudence and “sole-interest” standard.
2. Any benefit the investment may confer on other interests is not the responsibility or within the ability or control of CalPERS, but only of those who manage or are otherwise responsible for the target enterprise.

B. Asset Selection Criteria

The primary emphasis of the Program is in the State of California. The primary types of CURE projects covered by this Policy are outlined in the succeeding paragraph.

1. Residential, office, retail, entertainment, hotel, and mixed-use projects shall be considered. Asset selection shall be based upon traditional real estate measurements for long-term sustainability.

CalPERS shall consider projects and development sites characterized by the following key elements:

- a. Sufficient size to create a mix of uses and critical mass;
  - b. Single ownership and control;
  - c. Compatible surrounding land uses and densities;
  - d. Environmentally clean or manageable remediation; and,
  - e. Access to public and private transportation routes, housing, retail services, and amenities.
2. Other projects that may not be specifically defined below, but that benefit certain economic groups or geographic areas and meet the risk/return objectives of CalPERS, may also be considered. This Policy addresses investments in both existing and development projects.
    - a. Low-income Housing - Rental or for-sale housing projects with a portion of the units targeted for low-income or very-

low income residents. (Low-income is defined as 80% of median income; very-low income is defined as 50% of the median income.)

This category may include acquisition financing for public agencies seeking to purchase “at risk” rental projects where affordability is endangered by expiring rent restrictions. CalPERS may consider investing in for-sale projects with restricted affordability up to 120% of median income level when sponsored by a public agency attempting to promote home ownership. CalPERS shall require financial sponsorship or other assistance by the appropriate governing public agency prior to investment.

- b. Multi-family Low-income Housing - Small group-care housing or shelters for disadvantaged groups. Additionally, this type of housing encompasses community development loan programs sponsored and subsidized by public or private entities offering low-interest loans and attractive terms to residents within a specific geographic area for neighborhood revitalization.
- c. Economic Development or Redevelopment - Commercial, industrial, mixed-use, residential development or revitalization projects that may or may not leverage public resources. Their design directly benefits businesses, employees, or residents of low-to-moderate-income areas, or underserved markets.
- d. Urban Infill and “Smart Growth” Strategy - The acquisition, development, redevelopment, repositioning, conversion, and eventual disposition of office, retail, residential, hotel, and mixed-use projects. Smart Growth encompasses assorted initiatives addressing the increasing concern of communities about suburban sprawl and its impact on communities, open space, air quality, traffic congestion, and existing infrastructure. Many of these communities are redirecting development and infrastructure investment within the existing core. CalPERS shall seek profitable investment opportunities consistent with these trends. Such opportunities may include investment in traditional urban cores, urban infill, and suburban infill.

#### C. Investment Vehicles and Structures

CalPERS shall invest in CURE projects through equity structures and investment vehicles as allowed under the Policy.

1. For existing projects, the preferable structures include, but are not limited to, the following:
  - a. Commingled funds.
  - b. Direct equity investments.
  - c. Direct mortgages.
2. For development projects, the preferable structures include, but are not limited to, the following:
  - a. Commingled funds.
  - b. Direct equity investments.
  - c. Equity joint ventures.
  - d. Convertible participating mortgages.

CalPERS shall make investments in community housing and development projects through the assistance of investment advisors, affiliates, or partners familiar with such transactions.

D. Underwriting Criteria

Underwriting standards shall include demonstrated records of accomplishment in similar projects. Standards shall also include access to additional capital, if necessary, covering potential cost overruns, and no secondary collateral requirements unless essential. Where projects meet the underwriting criteria, CalPERS shall consider pricing concessions to support affordability on a case-by-case basis.

**PUBLIC REAL ESTATE EQUITY SECURITIES (PREES)**

**AprilFebruary 17, 2009**

**I. PURPOSE**

Unique advantages of investment in PREES include the following:

- A. Liquid, efficient, and cost-effective exposure to real estate generally;
- B. Exposure to real estate segments that are not available through the direct or private market therefore enhancing diversification;
- C. Facilitation of liquidity to maintain target allocations;
- D. PREES have unique risk and return characteristics reflective of the favorable tax treatment at the corporate level and the resulting distribution of income in the form of dividends; and,
- E. PREES provide for a strong corporate governance structure.

**II. INVESTMENT APPROACHES AND PARAMETERS**

A. Allocation to PREES

- 1. The allocation to PREES within the Portfolio shall be at the prudent direction of the SIO-RE subject to: diversification limits in the Real Estate Policy and discretion ~~amounts~~ allowed in the Real Estate Delegation Resolutions. The factors considered in asset allocation and selection shall include, but are not limited to, the following:
  - a. The difference in valuation in the public versus the direct market in general or for a particular property type or company;
  - b. The ability to complement exposures in the direct real estate program;
  - c. The need for liquidity to facilitate a target allocation; and,
  - d. Niche opportunities presented in the public market.

## B. Investment Styles

The Program may be managed internally or externally on a passive, enhanced or active basis subject to the following parameters:

	U.S.	Ex-US
Passive	Internal and External	Internal and External
Enhanced Index	Internal and External	External
Active	External	External

### 1. [Passive Portfolio](#)

- a. Under direction of the Real Estate Unit, the passive portfolio may be managed internally by the Global Equities Group.
- b. Trading activity will result from the execution of portfolio allocations made by the SIO-RE and will occur as often as necessary to maintain the desired positions of each security.
- c. Passive portfolios will attempt to replicate the characteristics and performance of the [benchmark index](#). A benchmark index may be a subset of a market index after screening for sufficient liquidity as expressed by [market capitalization](#) or other criteria.
- d. The passive portfolio shall undergo [reconstitution](#) periodically as appropriate to the type of index.

### 2. Enhanced Index Portfolio

An enhanced index approach may be used to create a portfolio of stocks that mirror the performance of the benchmark index. The weight of each security shall be close to the weight of each security in the benchmark index. The per annum return of the enhanced index shall be within 1.5% per annum [tracking error](#) from the benchmark index.

### 3. Active Portfolio

Real Estate Staff may select a group of external managers for the active portfolio. Manager selection and allocations shall be



approved by the SIO-RE and Real Estate Consultant in conjunction with the Request For Proposal process if applicable. [Short selling](#) strategies shall only be allowed in the domestic portfolio by external active managers after approval of the SIO-RE and Real Estate Consultant. Performance criteria will be suited to the strategy and geographic mandate.

C. Monitoring

1. Each PREES sub-portfolio will have a benchmark index appropriate to its strategy and geographic mandate. Performance criteria and benchmark indices for the program shall be determined by Staff and the Real Estate Consultant.
2. Trading costs shall be measured no less than quarterly to ensure proper trading activity management. Staff shall report monthly internally to senior management, including but not limited to, the current market value of the portfolio and the performance of the portfolio versus the benchmark index as reported by the master custodian.
3. An over/under weight report shall be generated monthly to display the weight of all stocks in the portfolio relative to the benchmark index weights.

D. Permissible Investments

1. Securities that constitute the chosen benchmark index.
2. Securities which are companies in partnership or strategic alliances with CalPERS in managing and owning real estate.
3. Securities that are not contained in the benchmark index but nevertheless present a niche opportunity and provide a complement to the Portfolio.

E. Single Stock Concentration

Any security position which represents more than 5% of the outstanding shares of that security shall be liquidated as soon as it is cost effective to do so to avoid SEC reporting requirements and liquidity constraints.

**Appreciation Return**

The percentage change in the market value of a property or portfolio, adjusted for capital improvements and partial sales, over a period of analysis.

**Benchmark Index**

The benchmark index will be a standard to judge the performance of the portfolio. A benchmark index may be a subset of a market index after screening for sufficient liquidity or other criteria.

**Co-investment**

The capital of the general partner or investment manager, sponsor, and manager of a separate account~~joint venture~~ or commingled fund which is invested~~s~~ in the venture.

**Commingled Fund**

An investment vehicle that pools individual accounts of multiple investors, which includes CalPERS. Each account holder owns units of the commingled fund similar to holding shares in a mutual fund.

**Credit Accommodation**

The term generally refers to a guaranty executed by CalPERS whereby CalPERS agrees to pay the debt obligation of an entity, in the event the entity fails to pay the debt obligation. The entity will usually be a limited partnership or limited liability company, and will be majority-owned by CalPERS. The debt obligation that CalPERS guarantees will be evidenced by an extension of credit (e.g., loan, line of credit, or other form of credit facility) by a financial institution to the entity. The benefit provided to CalPERS is that the guaranty will tend to lower the borrowing cost for the entity and should, in turn, enhance the overall return to the real estate investment. Guarantees become a contingent liability on the CalPERS' overall balance sheet and should be used only when they provide economic benefit. Credit accommodation differs from credit enhancement in that a credit accommodation is not rated and does not derive its rating from the CalPERS' Credit Enhancement Program (CEP) rating (either implied or explicitly). In addition, Credit Accommodation is made for an entity in which CalPERS has an existing, or proposed, ownership interest. Credit enhancement is the use of CalPERS' balance sheet, through the program rating, in which CalPERS has no initial ownership interest and where CalPERS receives explicit consideration for the enhancement.

**Credit Accommodation Outstanding**

The total amount of credit accommodation that is currently being utilized on investments.

**Custodian**

A bank or other financial institution that provides custody of stock certificates and other assets of an institutional investor.

**Debt Financing Amount**

Refers to any debt financing amounts committed to a relationship. May include, but is not limited to, public, private, secured or unsecured, fixed or variable rate credit lines, subscription lines, credit guarantees, credit accommodations, credit enhancements, property debt, portfolio debt, joint venture or entity debt for commingled funds, separate accounts or targeted transactions.

**Debt Service Coverage Ratio**

The annual net operating income divided by the annual debt service.

**~~Delegation Resolution~~**

~~A separate resolution and document that conveys authority from the Investment Committee to Staff to execute investment transactions that comply with guidelines.~~ **[Definition moved to “Real Estate Delegation Resolution”.]**

**Developed Real Estate Markets**

Markets domiciled in high-income countries, as defined by the World Bank, that most investors consider to have a well-developed operating and regulatory structure for its capital markets. These markets are included in the FTSE Benchmark Classification as Developed Markets.

**Disposition Amount**

Refers to any equity amounts committed for disposition to a relationship. May include, but is not limited to, annual dispositions, multi-year dispositions or commitments to commingled funds, separate accounts or targeted transactions.

**Downstream Joint Ventures**

Downstream Joint Ventures are partnership agreements executed by the operating partner of a joint venture funded by CalPERS (the Upstream Joint Venture).

**Emerging Real Estate Markets**

A market classified by FTSE as an emerging market based on an assessment of World Bank gross national income per capita, as well as factors related to the market and regulatory environment, custody and settlement, trading, development of a derivatives market and size of the country's stock market. Emerging Real Estate Markets are distinguished from: (1) Developed Markets which are markets domiciled in high-income countries, as defined by the World Bank, that most investors consider to have a well-developed operating and regulatory structure for its capital markets. These markets are included in the FTSE Benchmark Classification as Developed Markets. (2) Frontier Markets which are markets domiciled in low-income countries, as defined by the World Bank, whose capital market structure and regulatory mechanisms are not

developed enough to be included in Emerging Markets. These are markets that are investable but not classified by FTSE as Developed or Emerging Markets. (3) Uninvestable Markets which are those markets that are not classified by FTSE as Developed, Emerging, or Frontier Markets. These markets generally lack a convertible currency and do not allow for investment by non-residents.

### **Fair Market Value**

An valuation accounting term defined as the highest cash price a property would bring if exposed for sale in the open market by a willing seller to a willing buyer with both parties to the transaction being fully informed of all the uses and purposes to which the property is reasonably adaptive and available.

### **Financial Times Stock Exchange (“FTSE”) European Public Real Estate Association (“EPRA”) National Association of Real Estate Investment Trusts (“NAREIT”) Global Net Total Return Real Estate Index**

A Global Net Total Return Real Estate Index designed to track the performance of listed real estate companies and Real Estate Investment Trusts worldwide.

### **For Sale Residential (see also Land Development)**

Includes land primarily zoned as for sale residential or land held with the expectation of being rezoned to residential use. Includes path of growth investments, land development transactions, and construction of homes. Projects can be attached housing (typically condominium projects) or detached single family housing.

### **Frontier Real Estate Markets**

Markets domiciled in low-income countries, as defined by the World Bank, whose capital market structure and regulatory mechanisms are not developed enough to be included in Emerging Markets. These are markets that are investable but not classified by FTSE as Developed or Emerging Markets.

### **General Pension Consultant**

An individual or organization that provides specialized professional assistance to the Investment Committee in determining the pension fund's asset allocation model or optimal combination of investments in order to maximize risk-adjusted investment returns in a manner consistent with the State's long-term pension liabilities.

### **Hedge (Hedging)**

A strategy used to offset investment risk. A perfect hedge is one eliminating the possibility of future gain or loss.

### **Hotel**

Includes budget, mid-scale, upscale, luxury, and extended stay properties. May include attached convention centers, retail, parking structures and entertainment facilities. Development projects (vertical construction) which are primarily hotel are included in this category.

### **Housing Joint Ventures**

Housing joint ventures refer to partnerships that own properties that are acquired with the intention to develop or construct homes, including all forms of development for single family housing, such as condominiums, town homes, zero lot line developments, planned unit developments with and without common areas, and standard subdivisions.

### **Incidental Development**

Incidental commercial/multi-family infrastructure lot development may be undertaken in the program, provided that it is not a major cost of the overall single family project.

### **Industrial**

Multi-tenant or single tenant buildings including manufacturing, warehouse (logistics), light industrial/assembly, truck terminals, trailer storage lots and bulk distribution. Also includes Research and Development, Flex and Office Showroom space. Typically a portion of the building is finished out into office space. Development projects (vertical construction) which are primarily industrial are included in this category.

### **Independent Fiduciary**

A consulting firm which has undergone a review process and has been accepted into the spring-fed pool. Independent Fiduciaries are hired by staff to complete third party reviews of investment decisions approved by the Investment Review Committee.

### **Interest Rate Caps**

Designed to provide insurance against the rate of interest on a floating rate loan rising above a certain level (known as the cap rate).

### **Interest Rate Collar**

A security which combines the purchase of an interest rate cap and the sale of a interest rate floor to specify a range in which an interest rate will fluctuate.

### **Interest Rate Swaps**

Private agreements between two parties to exchange cash flows in the future, according to a pre-arranged formula.

### **International**

Any geographic location other than the eight domestic U.S. NCREIF regions and the territory of Puerto Rico.

### **Investment Amount**

Refers to any equity amounts committed for investment to a relationship. May include, but is not limited to, annual allocations, multi-year allocations or commitments to commingled funds, separate accounts or targeted transactions.

### **Investment, Disposition, and Debt Financing Amounts**

Refers to the sum of the three individual definitions for Investment, Disposition, and Debt Financing Amounts. The combined term is utilized in the Policy and Real Estate Delegation Resolution to describe transactions which staff will or will not have discretion to execute.

### **Joint Venture**

A partnership, limited liability company or corporation formed by~~between two or more entities for the purpose of~~investing or operating a business as co-owners~~capital in the joint venture. Typically one partner is the active manager and provides a small percentage of the capital (2 to 20%). The limited member (or limited partner) provides a majority of capital and typically retains control rights. Legal structures utilized include Limited Liability Corporations and Limited Partnerships.~~

### **Key Policy Parameters**

Analytical measures of the Real Estate Portfolio which have limits and ranges, or both, specified in the Real Estate Policy. The Key Policy Parameters are:

1. Risk Classifications;
2. Geographic Guidelines;
3. Property Type;
4. Public Securities Limitation;
5. Loan to Value Limits;
6. Debt Service Coverage Ratio; and
7. Recourse Debt Limitation.

### **Land Development**

~~Is~~ The entitlement, subdividing and construction of infrastructure for a land parcel. Typically subdivided parcels are then sold to a third party for vertical construction. Land development transactions typically have portions which are zoned and planned for commercial and portions which are planned for residential.

### **Land Entitlement Risk**

Land entitlement risk reflects the risks assumed by an investor when purchasing a parcel of land prior to the tentative map and other discretionary governmental~~political~~ approvals necessary for development being granted by the appropriate regulatory authorities~~bodies~~.

### **Leverage**

The use of borrowed money to make an investment, including all forms of~~amount of debt and financing structures secured by an asset or partnership. Includes mortgages, lines of credit, and subscription lines.~~

**Market Capitalization**

A stock's current market price multiplied by the current common shares outstanding.

**Mixed Use Properties**

Properties that are any mix of the five product types: office, retail, industrial, multifamily and hotels. Properties that include only a small percentage of a second product type are generally not considered mixed use (for example, an office building with a retail shop). Staff will develop procedures to allocate Mixed Use Properties by property type.

**Multifamily**

Includes high-rise, low rise and garden style rental residential properties. May be specialized rental properties such as student housing, military housing, affordable housing or age restricted housing. Development projects (vertical construction) which are primarily multifamily are included in this category.

**National Council of Real Estate Investment Fiduciaries (NCREIF) Index**

A property level performance benchmark for institutionally owned real estate. The benchmark is composed of an income return, an appreciation return and a total return and is calculated on a quarterly basis.

**Net Asset Value – NAV**

The Net Asset Value or NAV is a term used to describe the value of an entity's assets less the value of its liabilities.

**Non-recourse Debt**

Debt that may be recourse to a Separate Account or a Commingled Fund but for which CalPERS has no obligation.

**Office**

Includes central business district high-rise and suburban low and mid-rise buildings with finished office space. May be single tenant or multi-tenant. Includes specialized buildings such as medical office buildings and government buildings. May include attached parking structures and miscellaneous uses. Development projects (vertical construction) which are primarily office are included in this category.

**Operator**

Any individual, partnership, or limited liability company or corporation which is responsible for day to day management of a commingled fund or joint venture. Also known as the General Partner, Managing Member, Manager, etc.

**Other Property Types**

Includes real estate related assets not included in one of the following categories: office, industrial, retail, multifamily, hotels, for sale residential, or senior housing.

Examples would include Real Estate Operating Companies and Self Storage Facilities.

### **Passive Portfolio**

Investing in a manner that attempts to replicate the characteristics and performance of a market index. In theory, passive investing/management assures investment performance is neither worse nor better than the market as a whole. In practice, actual results differ from the results reported for the index due to transactions costs and tracking error.

### **Public Real Estate Securities**

Real estate securities, including real estate investment trusts (REITs) and real estate corporations, whose securities are publicly-traded.

### **Real Estate Consultant**

A consulting firm hired by the Committee to advise the Committee on Real Estate issues. The Real Estate Consultant reports to the Committee.

### **Real Estate Delegation Resolution**

A separate resolution and document that conveys authority from the Investment Committee to Staff to execute investment transactions that comply with guidelines.

### **Real Estate Operating Companies**

Companies with revenue derived from real estate services such as property management, brokerage, construction, development and investment management.

### **Real Estate Manager**

A firm hired to manage a real estate portfolio (typically public securities) for CalPERS.

### **Real Estate Partner**

A firm which acts as the general partner or investment manager in a separate account or commingled fund in which CalPERS has an investment.

### **Real Rate of Return**

A nominal return adjusted for the impact of inflation.

### **Real Estate Strategic Plan**

A multi-year plan that describes how the Real Estate Unit and Portfolio will be structured, staffed, and managed. The plan also addresses how to invest, where to invest, and how much to invest. Additionally, the plan states the objective and role of CalPERS' overall investment portfolio.

### **Reconstitution**

The screening which occurs periodically for potential additions or deletions to the index. The screening examines the market capitalization of Real Estate



Investment Trust (REIT) stocks, their content, concentration of ownership and position in the market sector. Stocks which no longer meet the criteria of the REIT index according to this policy will be eliminated from the index while new stocks which have qualified in the past year are included. A tolerance level will be applied to stocks which have dropped from the index since the past year in order to minimize transactional costs.

**Recourse Debt**

Recourse debt is debt for which CalPERS has the obligation (direct or indirect, absolute or contingent) to pay the debt to the lender.

**Recourse Debt Allocated**

The amount of recourse debt which has been allocated to an investment strategy and may or may not have been drawn or utilized to date.

**Retail**

Multi-tenant or single tenant buildings where tenants sell goods, food, services, or entertainment. Includes enclosed malls, open air malls, power centers, neighborhood centers and street retail. Also includes theaters and entertainment centers. Development projects (vertical construction) which are primarily retail are included in this category.

**Risk Adjusted Rate of Return**

The total return adjusted for volatility of returns over time. That is, for two investments having an equal total return over an investment period, that investment which experiences the least volatility of returns has the higher risk-adjusted rate of return. The standard calculation of risk-adjusted rate of return is the "sharpe ratio," defined as the difference between the investment return and the average T-Bill rate over the same period, divided by the standard deviation of the investment return over the period.

**Senior Housing**

Includes independent living, assisted living, skilled nursing, and congregate care facilities. Development projects (vertical construction) which are primarily senior housing are included in this category.

**Senior Investment Officer of Global Real Estate**

The Senior Investment Officer is responsible for all Global Real Estate programs and reports directly to the Chief Investment Officer of CalPERS.

**Separate Account**

A partnership between CalPERS and a Real Estate Partner through which the Real Estate Partner manages Investment, Disposition, and Debt Financing Amounts of behalf of CalPERS.

**Short Selling**

Selling securities that are not owned and buying them back later to: 1) take advantage of an anticipated decline in the price; or 2) to protect a profit in a long position.

**Side by Side Investment**

An investment made along side a commingled fund typically in a property too large for the fund to absorb. Terms for side by side investment may be more favorable than those of the commingled fund.

**Spring-Fed Pool**

A list of outside consulting firms selected based on RFI or RFP processes which serve as independent fiduciaries for the Global Real Estate Unit.

**Subscription Financing**

Subscription financing is a form of leverage in which debt incurred by an investment partnership is secured by the capital commitment of an investor, which may be used to pay the debt for the investment partnership.

**Subscription Financing Allocated**

The amount of subscription financing which has been allocated to an investment and may or may not have been drawn or utilized to date.

**Subscription Financing Outstanding**

The amount of subscription financing that is currently being utilized on investments.

**Staff Internal Procedures Manual**

A manual that describes the detailed procedures Staff is required to follow in managing the Real Estate program including the investment process.

**Total Return**

The sum of the appreciation return and income return.

**Tracking Error**

The annualized standard deviation of the difference between the total return of the portfolio and the total return of the benchmark. The term tracking error is frequently used to describe return deviation, the total return of a portfolio, minus the total return of a benchmark index.